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More Inflation Ahead?

Edward D. Allen
Iowa State College

MORE INFLATION AHEAD?

By EDWARD D. ALLEN

EVEN THOUGH modified price control has been restored for a limited period, we are all conscious of upward pressures on prices. Despite all our controls during the war period, these pressures had already produced a rise in the cost of living of 35 percent by July of this year. Are we in for a lot more? It is the purpose of this article to review the inflationary and counter-inflationary factors that will operate in the period ahead.

At the outset we can say that the inflation problem is largely a problem of controlling the rate of spending by buyers and the consuming public in relation to the rate of production. We must also recognize that inflation is only one aspect of the bigger problem of economic stability. Current planning for holding inflation in check should also reckon with the probability of future deflation.

Heavy Buying

We are now in a period during which there will be a gigantic effort by consumers to satisfy their accumulated backlog of demand for durable goods (cars, farm machinery, stoves, washing machines, etc.) and housing. Industry has not yet been able to get production of durable goods and housing anywhere near in line with demand. Demand for non-durable goods is at a high level now, too, but production in this field has been high since the spring of 1946. In mid-1946 production of non-durable goods was the highest in history.

The government is cutting its purchases of goods and services sharply, so that additional productive capacity is available for civilian purposes. We have reduced the armed forces from 12.3 million in July 1945 to around 3 million in July 1946. This figure will be further reduced to about 2 million in the near future. In spite of this rapid addition of manpower to our working force, unemployment has never crept above 2.7 million since the war. Notwithstanding the dire predictions a year ago, the economy is now running in full gear. Such unemployment as we have is little more than the minimum amount which is unavoidable because of changes in jobs.

In short, we do not have much "slack" left to take up in shifting to a peacetime economy. We are in the midst of a good-sized post war industrial boom. Production is at a high level and increasing—but there will be a considerable lag between production of durable goods and housing and demand for these goods.

Production the Answer?

We have heard a lot about production being the answer to inflation—which of course it is. But it is apparent from a study of the situation in mid-1946, that we cannot possibly increase production of durable goods and housing fast enough to meet the demand at existing prices. To say it in another way, demand may force some additional increases in the prices of these items, even with continued price control.

Not only are current incomes at a high level and increasing as production increases, but the quantity of liquid funds in the hands of consumers is much the greatest in history. Various government agencies have made surveys of liquid assets since the end of the war. While these surveys disagree as to exact amounts, they are consistent in reporting that the liquid assets held by individuals have increased from three to three and one-half times since the war began. (Liquid assets include cash, bank deposits and holdings of U. S. government securities, which can be turned into cash either immediately or on short notice.)

Accumulated idle funds of themselves, however, are only "inflation potential." They are the means for a spending spree, but whether they will be widely used for bidding up prices remains to be seen.

Savings Concentrated

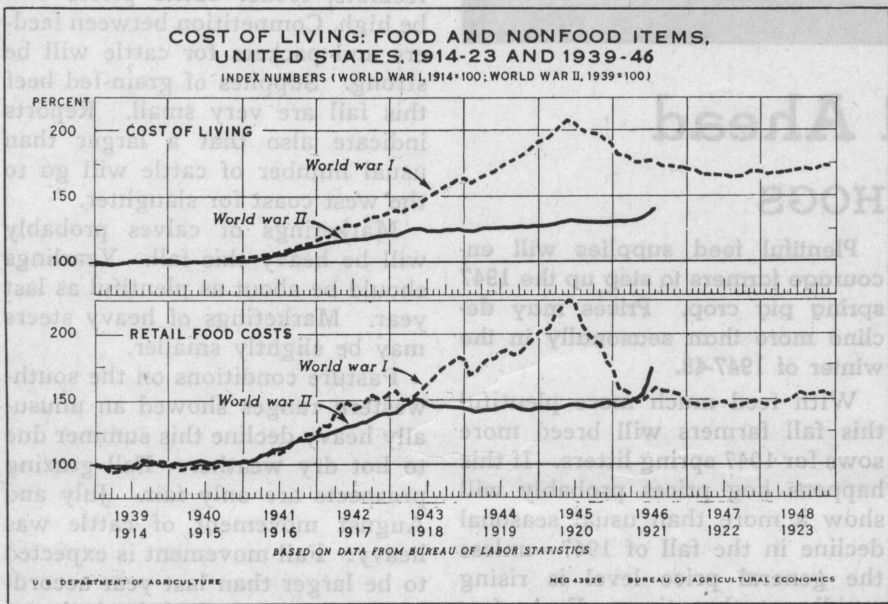
A survey made by the Bureau of Agriculture Economics provides some guidance on how people may use these wartime savings. It shows that liquid assets are highly concentrated. BAE reported that 60 percent of the bank deposits and savings bonds are held by 10 percent of the people. Half of the people have virtually no savings at all—only 3 percent of total liquid assets. This concentration of assets might suggest that the high income families of the country have all the savings and that we needn't worry about additional heavy spending for consumer goods by them.

However, when savings are related to incomes, we find that a sizeable proportion of the savings are held by low and moderate income families. In fact, it is estimated that 43 percent of the liquid assets are held by families with incomes from $2,000 a year to $5,000. In other words, though liquid assets are concentrated, they are not necessarily all held by high income families.

Rate of Spending

A sharp rise in the cost of living undoubtedly would influence many of these moderate income families to draw upon their savings for current purchases. People who did not need the money for current living would be inclined to put their money in durable goods or houses in the hope of avoiding the loss in value as prices rose.

The BAE study indicated that most families who held considerable savings in cash or bonds did not intend to use them in 1946 or the immediate future. Consumers said that they had no intention of using their liquid assets to finance purchases of durable goods and housing to any great extent. In total, they expected to spend between 5 and 7 billion dollars. This is not a very big chunk of total liquid assets held by individuals, which have been estimated by the Federal Reserve Board at about 130 billion dollars as of the end of 1945.



These 5 to 7 billion dollars do not represent total prospective spending for durable goods and housing but only cash outlays. Consumers indicated that they plan to buy 20 to 25 billion dollars worth of durable goods and housing in 1945. They plan to finance these purchases partly by installment and mortgage credit and partly by incomes secured from current production. Actually, demand for installment and mortgage credit has grown rapidly this year. This result of the survey verifies earlier surveys made during the war which showed people did not intend to splurge with their wartime savings after the war.

In connection with this point, Alvin H. Hansen, Harvard University economist, has pointed out that historically, businesses and individuals have wished to hold more and more money in relation to the level of income. In 1840, the U. S. public held 10 cents of money (currency and bank deposits) per dollar of national income. This figure increased gradually to 85 cents in 1940 and currently is about 95 cents. Even with heavy savings bond redemptions in the first quarter of 1946, new purchases still exceeded redemptions. For June, last month for which figures are available, the same is true.

The conclusion that wartime savings are firmly held seems to stand up. However, we must not conclude from that that spending will not be influenced by savings. As has been pointed out, the existence of the savings tends to cause people to spend more out of current income and to use more installment credit. Further, we must recognize that businesses and individuals cannot be expected to maintain firm control over savings in the face of a "blow-up" price inflation which would lower the value of these assets.

Controls Still Needed

For the duration of our reconversion to full production of durable goods (a period which we hope will coincide with the life of the re-enacted OPA, but may not) we will need to continue some direct controls over prices. We also will need to continue heavy taxation in order to keep spendable income and the value of available output at current prices as nearly together as possible. These suggestions would be much easier to put into effect if we had not discarded our systems of wage control and rationing at the end of the war. In the absence of wage control, we must keep prices reasonably stable or a serious wage-price spiral will be on our hands.

Fiscal Flexibility

For the longer run, what we need is a policy of fiscal flexibility, that is, a determination to maintain a balance between demand and supply by appropriate government taxing and spending policies. Sooner or later our present restocking boom will come to an end. To meet the possibilities of a slump, the government should announce now its intentions to follow boldly a policy of fiscal flexibility.

Fiscal flexibility now means (1) high taxes, (2) reduced government spending and (3) price controls on selected goods and rent. In time of depression, it means planned reduction in taxes and increases in government expenditures—just the reverse of what is involved in times of boom. What is required is a fiscal policy that is prepared to cope with both inflation and deflation, planned in advance and put into operation as needed. Canadian planning undertaken last summer recognizes this. We have yet to accept its substance in this country. A plan for flexible fiscal policy was the heart of the Full Employment Act debated last winter. The Act finally was adopted but in anemic form. It may be that we may have to go through another boom and crash cycle before we are ready to take necessary action to keep the economy on even keel.

Southern farmers held down their cotton acreages this year, despite a price rise. Cotton prices this spring were 2.5 to 3.5 cents higher than a year ago. Yet cotton acreage in cultivation on July 1 in this country was only 3 percent larger than a year earlier.

Favorable prices for competing crops were partly responsible for this. Other causes are: Increased cost of farm labor, unfavorable weather at planting time in much of the cotton belt and machinery shortages.

This year's grain sorghum crop is the smallest since 1939.